VZCZCXRO7476
RR RUEHBZ RUEHDU RUEHGI RUEHJO RUEHMA RUEHMR RUEHPA RUEHRN RUEHTRO
DE RUEHSA #2315/01 3171508
ZNR UUUUU ZZH
R 131508Z NOV 09
FM AMEMBASSY PRETORIA
TO RUEHC/SECSTATE WASHDC 0197
INFO RUCPDC/DEPT OF COMMERCE WASHINGTON DC
RHEBAAA/DEPT OF ENERGY WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUCNSAD/SOUTHERN AF DEVELOPMENT COMMUNITY COLLECTIVE
RUEHZO/AFRICAN UNION COLLECTIVE

UNCLAS SECTION 01 OF 04 PRETORIA 002315

SIPDIS
SENSITIVE

STATE PLEASE PASS USGS
DEPT FOR AF/S, ISN, EEB/ESC and CBA, and OES/EGC
DOC FOR ITA/DIEMOND
DOE FOR T.SPERL, G.PERSON, A.BIENAWSKI, M.SCOTT, L.PARKER
TREASURY FOR D.PETERS, P.STEWART

E.O. 12958: N/A
TAGS: ENRG EPET EMIN EINV ETRD ECON SENV PGOV SF
SUBJECT: Eskom Leadership Crisis Exacerbates Capacity Challenges

REF: A) Pretoria 2166; B) Pretoria 1762

This message is sensitive but unclassified, not for Internet distribution.

Summary

¶1. (SBU) South African power utility Eskom is in crisis with recent resignations of Board Chair Godsell and CEO Maroga, just as the company and its shareholder, the South African Government, grapple with financing for huge capital investments needed to meet electricity demand and avoid brown-outs, or - in the worst case - a shut-down. Proposed rate hikes are meeting strong resistance from residential and industrial customers. Economists estimate that proposed rate hikes of 45 percent a year for three years would increase inflation by about half a percent per annum. Gold miners claim rate increases would increase their operating costs by up to 30 percent over three years. Given that today's prices are well below market, these rate increases are needed to economically justify new capacity (coal or alternative energy). The only other alternative would be significant subsidies that the government cannot afford. End Summary.

Management Crisis

¶2. (SBU) An epic boardroom battle at Eskom over future strategy and blame for the 2008 power crisis has led to uncertainty at the helm. The byzantine timeline was as follows: Some time during the last week of October, the Eskom Board of Directors asked Chief Executive Officer Jacob Maroga - at the helm during the power crisis (see Ref A and previous)- to resign. Eskom Board Chairman Bobby Godsell, who was brought in as a fixer in July 2008 after the power crisis, told Eskom staff November 5 that the Board had accepted Maroga's resignation. Friday, November 6, a press conference was called, then abruptly cancelled. Various groups decried or acclaimed Maroga's departure, then reports surfaced that Maroga had not/not resigned. Godsell met with President Zuma on Sunday, November 8; there were no reports on what was said in that meeting. Godsell himself resigned November 9 over lack of government support. As with Maroga, various groups decried or acclaimed Godsell's departure. Finally, on November 12, the Acting Eskom Board Chair, Mpho Makwana, put out a formal statement reporting Maroga's resignation.

¶3. (U) Two contrasting vision documents presented earlier to the board by Godsell and Maroga were provided to the press. In his

"turnaround strategy" document, Maroga introduced the issue of race, claiming over-reliance on "white supervisors." Maroga's vision document also referred to a choice of U.S. "Change Management Consultancy" Telein Group Inc. as his "leadership and organizational effectiveness advisors, rather than traditional business consultants." Godsell's document was more narrowly focused on how the Board, the CEO, and the SAG needed to work together, but did express concern about "the time, responsibility and stress burden being carried by our CEO and his executive team" and that the company was "failing to deal decisively with a number of important issues."

¶4. (SBU) Maroga is said to have been defended by President Zuma. The ruling party (ANC) youth league and Black Management Forum also QThe ruling party (ANC) youth league and Black Management Forum also came out in Maroga's support, with some accusing Godsell and others of racism. Godsell supporters include Eskom's board and staff, labor unions and industry observers. The National Union of Mineworkers, which has about 11,000 members employed by Eskom, as well as the COSATU General Secretary, insisted Godsell is not a racist, and ANC secretary-general Gwede Mantashe said that the matter should not be simplified into a racism issue. On November 13, media reported that Barbara Hogan, Minister of Public Enterprises, favors Godsell's return.

¶5. (SBU) Maroga's tenure as CEO was marked by power shortages, a record loss of R9,7 billion ($1.3 billion) in its 2008/2009 financial year ending March 31, 2009, and controversy over price hikes to finance capital investments. Maroga received a controversial 27 percent salary increase in 2009, taking his annual salary to $674,000. Eskom spokesperson Andrew Etzinger admitted in a briefing for the American Chamber of Commerce on November 12 that personally, he had not thought "things could get any worse for Eskom than the crisis over load-shedding, but the current leadership

challenges have now added another challenge for the power utility."

CREDIT RATING WORRIES

¶6. (SBU) Political meddling and uncertainty in resolving the power struggle at Eskom have raised questions about the South African Government's management of Eskom and other state-owned firms. A political analyst at Standard Bank Securities, Alistair Sparks, said, "Serious institutions will be much more reluctant to lend money to Eskom, and if they do, it will be at a much higher interest rate because the risk seems to be higher." Eskom's total capital expenditure program is R385 billion (about $52 billion) to increase, modernize, and diversify electricity supplies, of which R270 billion is targeted for the next three years. The SAG has provided R60 billion as equity and R176 billion in loan guarantees (still to be raised in debt markets), leaving a gap of R40 billion. To cover the gap, Eskom is seeking a record loan of up to R23 billion ($3.1 billion) from the World Bank and lesser amounts from the African Development Bank and other international institutions. Eskom's credit rating fell over the past year amid uncertainty over funding plans for its expansion program. Three major global rating agencies said they were concerned about the leadership tussle, even as Science and Technology Minister Naledi Pandor dismissed fears that it would scare off investors.

Skills Crisis

¶7. (SBU) The Eskom crisis is further exacerbated by the high number of vacancies it faces for competent and skilled positions. A confidential Eskom report showed a vacancy rate of 50 percent in key posts during the load shedding crisis, the Democratic Alliance (DA) said on November 2. Cobus Schmidt, DA shadow deputy minister of energy, said his party was in possession of the report from Eskom's Corporate Technical Audit Department authored in late 2007 that was circulated internally just a few months before the country was hit by major electricity supply shortages. Schmidt said in a statement

the report showed in clinical detail how Eskom's management had comprehensively failed to address "critical vacancies" in two critical areas: senior management posts, and short and long term coal procurement positions.

Timing of Rate Hike Application

¶8. (SBU) Eskom has long called for significant rate increases to cover operating and capital costs and as an incentive for attracting private investment. The National Energy Regulator of South Africa (NERSA) issued a 25-page document on October 30 asking for public comment within a month on Eskom's proposed rate increases of 45 percent a year for three years beginning April 1, 2010. NERSA will organize public hearings in all provinces from January 11 to January 22, 2010, with a final determination on Eskom's tariff application by February 24, 2010.

Why such a Significant Increase?

¶9. (SBU) Eskom says it would require a 146 percent tariff increase to avoid running at a cash deficit in 2010-11, considering both Qto avoid running at a cash deficit in 2010-11, considering both operating and capital costs. To achieve this, the company requested even increases of 45 percent per year over three years. Investec analyst Annabel Bishop said the tariff increase of 31 percent approved in 2009 had not been sufficient to cover the utility's costs and led to the record $1.3 billion loss for its 2009 financial year. Eskom's operational expenses include the costs of water, coal, and imported diesel and nuclear fuel, as well as staff costs, consultancy fees, and maintenance. Eskom also faces an environmental levy, borrowing costs, depreciation, and coal road maintenance.

Reaction to the Proposed Increases

¶10. (U) There has been a significant outcry against the severity of

the proposed tariff increases from many areas of the economy, particularly from the retail and mining sectors. Retailer Pick n Pay (PnP) CEO Nick Badminton identified rapidly rising electricity costs as one of the big challenges the retailer would face in the medium term, speaking at PnP's interim results presentation. "This is a dramatic situation SA faces, not just for the business, but for the consumer. We need to sit down as a country and work out how to go forward. It would be a midsummer night's madness to allow this to go through."

¶11. (SBU) The Chamber of Mines economist told Energy Officer that what Eskom is asking for is not possible and it will get less. He argued that Eskom will never be the panacea for the power crisis; private participation and greater efficiency must be encouraged. "We can kiss the beneficiation of minerals goodbye," African National Congress secretary-general Gwede Mantashe said on November 6, asserting that three years of 45 percent increases could kill certain sections of the economy. Gold miners across the board are asserting that the proposed tariffs would increase the cost of gold production by up to 30 percent over three years. AngloGold Ashanti's chief executive Mark Cutifani expressed hope in finding a solution in consultation with Eskom and government, but said restructuring would be needed at his company's South African mines to ensure that they remain profitable. The combination of a stronger rand, higher electricity tariffs, wage increases, and temporary shaft closures has already lifted the company's operating cost of each ounce of gold by 18 percent quarter-on-quarter (to September) to $525. Gold Fields CEO Nick Holland said that the hikes would have a devastating effect on the industry and the economy. He explained that the higher tariffs would increase the cost of mining gold by 17 percent even before taking into account the knock-on effects of wages and steel prices. South Africa's

third-largest gold producer Harmony Gold Mining cautioned that the tariff hikes could increase its costs by over 15 percent a year. Harmony CEO Graham Briggs said electricity costs would then increase from 13 to 25 percent of total costs in three years. Briggs said the increases would boost the cost of steel and other commodities, while pushing inflation up to 2 percent higher. He added that as a result, wages would increase 8 percent to 10 percent a year (in contrast to the forecast 6 percent).

¶12. (SBU) New projects in a number of sectors based on South Africa's relatively "cheap" electricity have been cancelled or put on hold. It remains to be seen how existing long-term electricity contracts that attracted aluminum smelters and others will be handled.

¶13. (SBU) With respect to smaller users, increased tariffs could well cause an increase in non-paying customers; already a large percentage of consumers do not pay their bills and there are substantial illegal connections to the grid. Seventy-six to eighty percent of the South African population has access to electricity.

Macroeconomic Impact

¶14. (SBU) A consensus view is emerging among economists that the
Q14. (SBU) A consensus view is emerging among economists that the
proposed electricity price rises could add about half a percentage point to inflation and cut the economy's growth rate by half a percentage point or more, stalling recovery from the global recession.

Comment

¶15. (SBU) Eskom's leadership crisis weakens its ability to contend with its long-term power capacity and skills challenges. Current well-below-market power pricing precludes essential private investment in the sector. Without such investment, any substantial recovery in demand risks grid shut-down, which could take three weeks to restore. The government cannot afford significant subsidies as an alternative source of investment. At the same time, the company's request for a steep increase in electricity rates appears unlikely to be approved without modification. Loans from multilateral development banks, essential to the company's efforts to bolster electricity supply before demand recovers and surges during the World Cup games (mid-June to mid-July), will need to be carefully scrutinized by donors.

¶16. (U) BIO NOTE: Mpho Makwana was named by the Minister of Public Enterprises and the Board on November 12 as de facto interim executive chair, a chairperson with executive authority. Meanwhile, the board has initiated a process to find a new CEO. They hope to complete this within 90 days. Makwana was appointed as a non-executive director for Eskom in 2002, holds a Bachelor of Administration (Honors) degree in Public Management, and is also Chairman and founder of investment holding company Epitome Investments. Business Report noted that he served previously as Chief Executive of Saatchi and Saatchi in South Africa and sits on the Boards of Educor, WWF South Africa, and the International Marketing Council. Makwana is reported to be a member of the Alliance for New Humanity, founded by mind-body physician Deepak Chopra as a network for those wanting a more compassionate world. In a radio interview on November 12, Makwana dismissed accusations of racism at Eskom, noting that the board is diverse by race and gender with majority black representation. A number of black executives resigned during Jacob Maroga's tenure.

Gips